Case No. 05-1677

IN THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

William E. Stricker, Pamela Hines Stricker, Ozark Management, Inc. and Allergy & Asthma Consultants of the Ozarks, Ltd.

Plaintiffs/Appellants,

v.

David A. Johnson, Steven R. Berlin, Tom Kimball, Tammie Maloney, Jeff Sullivan, Donald L. McCorkell, Burt B. Holmes and John H. Knight,

Defendants/Appellees.

On Appeal from the United States District Court
for the Western District of Missouri
Central Division
The Honorable Nanette Laughrey

BRIEF OF APPELLANTS

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SUMMARY AND REQUEST FOR ORAL ARGUMENT

At issue in this case is whether plaintiffs, in their capacity as creditors, adequately stated a claim against the Board of Directors of Great Plains Airlines Holding Company for breach of fiduciary duty and gross negligence based on the company's insolvency. As courts across the country have long recognized, once a corporation enters the zone of insolvency, the Board owes a fiduciary duty to the company's creditors . Here, the district court refused to recognize this fiduciary duty.

Also at issue here is whether a creditor that is individually harmed by the Board's actions can sue in the creditor's individual capacity rather than derivatively on behalf of all creditors. Because Federal Rule of Civil Procedure 23.1 concerning shareholder derivative actions does not apply to creditors, and because plaintiffs here alleged individual injury apart from the corporation as a whole, plaintiffs were not required to bring such claims derivatively on behalf of unidentified and unknown other creditors of the company.

This case raises an important, but as yet unanswered question and deserves the benefit of oral argument to address the pertinent legal doctrines and the legal theories that support them. Because the case was dismissed on the pleadings and there are no factual issues to discuss, plaintiffs request fifteen minutes for oral argument.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Eighth Circuit Local Rule 26.1A, the undersigned certifies that appellants Ozark Management, Inc. and Allergy & Asthma Consultants of the Ozarks, Inc. have no parent corporations and no publicly held company owns ten percent or more of their stock.

Respectfully submitted,

/s/ Richard M. Paul III

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JURISDICTIONAL STATEMENT

The district court had subject matter jurisdiction over this case under 28 U.S.C. §§ 1331 and 1332 because plaintiffs alleged claims arising under federal law (violation of the Equal Credit Opportunity Act, 15 U.S.C. § 1691) that properly invoked the district court's federal question jurisdiction, and because all plaintiffs were citizens of different states than all defendants and the amount in controversy, excluding interest and costs, exceeded $75,000. The district court had supplemental jurisdiction over the state law claims under 28 U.S.C. § 1367.

On September 7, 2004, the district court dismissed all claims against the individual defendants on the defendants' motions to dismiss. On September 10, 2004, plaintiffs filed a motion for leave to amend their Complaint to restate the claims against those individual defendants who are Appellees in this appeal. Plaintiffs also filed a motion for reconsideration of the Court's September 7, 2004 order to accompany the motion for leave to amend. On November 16, the district court denied both motions. On March 4, 2005, the District Court certified its Orders of September 7, 2004 and November 16, 2004 dismissing all claims against the Appellees herein as a final judgment based on an express determination that there was no just reason for delay. Plaintiffs filed their notice of appeal to this Court on March 9, 2005.

This Court has jurisdiction over this appeal under 12 U.S.C. § 1291 and Fed. R. Civ. P. 54(b).

STATEMENT OF THE ISSUES

I. Did The District Court Err In Denying Plaintiffs' Motion For Leave To Amend Their Complaint Based On Its Determination That The Plaintiffs' Claims Were Derivative In Nature Rather Than Direct?

Cohen v. Mirage Resorts, Inc., 62 P.3d 720 (Nev. 2003)

Darrow v. Southdown, Inc., 574 F.2d 1333 (5th Cir. 1978), *cert. denied*, 439 U.S. 984 (1978)

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Snyder Electric Co. v. Fleming, 305 N.W.2d 863 (Minn. 1981)

STATEMENT OF THE CASE

Nature of the Case

The underlying case involved many parties and many claims arising out of the financing of a bankrupt airline carrier. At issue in this appeal is whether the district court erred in denying plaintiffs' motion for leave to amend their complaint to state claims for breach of fiduciary duty and gross negligence against the officers and directors of the failed airline carrier's holding company.

Course of Proceedings and Disposition Below

Plaintiffs asserted claims in the United States District Court for the Western District of Missouri against Union Planters Bank, N.A. ("Union Planters"), Great Plains Airline Holding Co., Inc. ("Great Plains"), David Johnson, David Smith, Steven Berlin, Tom Kimball, Tammie Maloney, Jeff Sullivan, Donald McCorkell, Burt Holmes, Steven Turnbo, John Knight, and James Swartz. (App. 28). Plaintiffs settled their dispute with Union Planters, and the Court entered a judgment based on that settlement. (App. 172). Plaintiffs dismissed their claim against Great Plains without prejudice based on Great Plains' Chapter 7 liquidation bankruptcy filing. (App. 163, 168).

Plaintiffs asserted claims against the individual defendants, who are all current or former officers and directors of Great Plains, for breach of fiduciary duty and gross negligence. The individual defendants filed motions to dismiss, which the district court granted. (App. 60, 77, 83, 90, 97). Plaintiffs then filed a motion for leave to

amend their Complaint to drop their claims against the individual defendants who had resigned as officers or directors of Great Plains before the wrongful conduct, and to restate the claims against the remaining individual defendants, who are the Appellees herein. (App. 106). Plaintiffs also filed a motion for reconsideration of the Order dismissing these claims. (App. 141). The district court denied both motions. (App. 147).

Because all claims against the individual defendants were dismissed while the claims against the other defendants were still pending, plaintiffs filed a motion to certify the Court's Order dismissing the Appellees as final for purposes of appeal under Fed. R. Civ. P. 54(b). (App. 153). The district court granted that motion. (App. 160).

Plaintiffs filed their notice of appeal on these claims. (App. 162).

STATEMENT OF FACTS

The facts, stated in the light most favorable to the plaintiffs, are as follows:

In 1999, plaintiff Dr. Stricker formed Ozark Air Lines, Inc. ("Ozark Air") for the purpose of building a regional jet passenger airline to operate from Columbia Regional Airport to improve access to mid-Missouri for personal and business travel, especially travel associated with the University of Missouri and state government. Ozark Air's regional jet service provided greater access to air travel and increased the attractiveness of Mid-Missouri as a place where new businesses could locate and conduct their affairs. (App. 115).

Plaintiffs financed Ozark Air's operations through Union Planters Bank, including a loan taken in the name of plaintiffs Dr. and Mrs. Stricker in the amount of $21,800,000.00 (the "Aircraft Loan"). The loan proceeds were used to purchase two Fairchild-Dornier jets and were contributed to Ozark Air as a capital contribution. Plaintiffs took out two other loans from Union Planters at this same time related to Ozark Air, both of which were paid in full. (App. 116-117).

The Aircraft Loan was secured by three separate security agreements. The first security agreement granted a security interest to Union Planters in the two jet aircraft contributed to Ozark Air. In the second security agreement, Dr. Stricker granted Union Planters a security interest in an airplane he owned personally. In the third security agreement, plaintiff Ozark Management granted Union Planters a security interest in five additional aircraft and an aircraft hangar facility. Union Planters also required all plaintiffs and Ozark Air to execute an "Unconditional Guaranty of Payment and Performance," which stated that each of the plaintiffs guaranteed each of the three loans. (App. 117-118).

After approximately one and one-half years of operation, the shareholders of Ozark Air decided to sell the stock of the company to Great Plains Airline Holding Company ("Great Plains"), an Oklahoma-based company charged by the Oklahoma legislature with starting and operating a regional jet airline carrier out of the Tulsa, Oklahoma airport. (App. 118-119).

On March 11, 2001, Great Plains, Ozark Air, and Dr. Stricker entered into a Stock Purchase Agreement in which Great Plains acquired all but 100 shares of the stock of Ozark Air from Dr. Stricker and the other shareholders for an adjusted purchase price of $6,134,635.00, plus the assumption of the Aircraft Loan at Union Planters. In the Stock Purchase Agreement, Great Plains assumed plaintiffs' payment and performance obligations under the Union Planters' loan documents. (App. 119).

As a condition of the sale, Great Plains required Dr. Stricker to purchase 100 shares of Ozark Air stock from Great Plains for $1 million. Dr. Stricker also assumed a position on the board of directors of Great Plains. (App. 119).

On March 20, 2001, Union Planters, the plaintiffs, Ozark Air and Great Plains signed a Loan Modification and Guaranty Agreement in which Union Planters acknowledged the assumption of the Aircraft Loan by Great Plains and provided for all payments on the Aircraft Loan to come from Great Plains and/or Ozark Air, but continued to name Dr. and Mrs. Stricker as the makers of the modified Aircraft Loan. Great Plains made all payments to Union Planters from that date forward. (App. 120).

Because Dr. Stricker did not want any liability on the Aircraft Loan when he had no personal ability to control the operations of the aircraft to ensure they were used to generate revenue to pay the loan, he demanded and received Great Plains' agreement in the Stock Purchase Agreement that it would remove plaintiffs as guarantors of the Aircraft Loan within one year of the acquisition, or sooner if Great Plains' net worth dropped below $7 million. (App. 120).

At almost every Great Plains board meeting after the sale, Dr. Stricker requested that Great Plains pay off or restructure the Aircraft Loan to remove plaintiffs from that obligation. Despite Dr. Stricker's repeated requests, the officers and directors of Great Plains failed and refused to make any meaningful effort to honor its contractual obligations. (App. 121).

Months later, after repeated requests by Dr. Stricker that Great Plains honor its obligation to remove him and his wife from the Aircraft Loan, Great Plains sent a meekly worded letter to Union Planters asking it to remove Dr. Stricker and his wife from its Aircraft Loan but offering the Bank no consideration in return. By letter dated May 6, 2002, Union Planters rejected Great Plains's written request. (App. 121).

On March 7, 2003, Union Planters sent a notice of default to Dr. and Mrs. Stricker because Great Plains failed to make several loan payments. Dr. Stricker immediately contacted Great Plains and demanded that it restructure its debt and/or take whatever actions were necessary to honor its obligation to remove Dr. and Mrs. Stricker from the Aircraft Loan. (App. 121).

Further, because the one-year time period was about to expire for Great Plains to remove Dr. and Mrs. Stricker from the Aircraft Loan under the Stock Purchase Agreement, plaintiffs requested that Great Plains secure the plaintiffs' position with a "Standstill Agreement" that required Great Plains to grant plaintiffs a security interest in all of Great Plains's assets, including the aircraft and FAA operating certificate, as well as a pledge of the Ozark Air stock. Union Planters refused to consent to Great

Plains granting the agreed upon security interest and, as a result, Great Plains refused to convey the agreed security. (App. 122).

Shortly thereafter and unbeknown to Dr. Stricker, the officers and directors of Great Plains negotiated a modification of the Aircraft Loan in which Union Planters made certain concessions favorable to Great Plains in an attempt to make the loan payments more manageable for Great Plains. Great Plains negotiated and executed this modification without consulting with or advising plaintiffs. Nevertheless, defendants included plaintiffs as signatories to the modified agreement. Great Plains then told Dr. Stricker that it would seek to hold him financially responsible for the demise of Great Plains if he did not sign the modification agreement to reduce Great Plains's payments on the Aircraft Loan. Union Planters likewise advised Dr. Stricker that he and his wife would either sign the modification agreement or else Union Planters would immediately accelerate payment of the Aircraft Loan and look to him as primary obligor. (App. 122).

Despite protesting, and based on the threats made by defendants, Dr. Stricker and his wife finally signed the modification agreement tendered by Great Plains and Union Planters. Despite being a nominal party on the restructured loan, neither Dr. Stricker nor his wife made any payments to Union Planters since selling Ozark Air in March 2001, nor did they have any control over whether any payments were made by Great Plains. (App. 123).

After signing the modification agreement, Dr. Stricker remained concerned about Great Plains' failure to remove the plaintiffs' from the Aircraft Loan and sought a buyer for Ozark Air that would assume or refinance the Aircraft Loan at Union Planters. But because Union Planters had objected to Great Plains' pledge of the stock of Ozark Air to Dr. Stricker, Dr. Stricker had no legal ability to force a sale of Ozark Air.

In July 2003, once it became clear that Great Plains had no intention of taking the necessary steps to remove Dr. Stricker and his wife as guarantors of the loan or of cooperating in the sale of Ozark Air, Dr. Stricker resigned from the board of directors. (App. 123).

In November 2003, Union Planters sent another notice of default to Dr. and Mrs. Stricker after Great Plains again failed to make the required loan payment. In December 2003, Union Planters sent yet another notice of default, this time to the Strickers, Great Plains, and Ozark Air. On January 9, 2004, Union Planters made a formal demand for repayment in full of the Aircraft Loan to the Strickers, Great Plains, and Ozark Air. (App. 123-124).

On January 23, 2004, Ozark Air filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Oklahoma. (App. 124). Shortly thereafter, plaintiffs filed suit against Union Planters, Great Plains, and the individual defendants. (App. 28).

Plaintiffs asserted claims for breach of fiduciary duty and gross negligence against the individual defendants because of their decision as officers and directors of Great Plains to treat Plaintiffs' guaranty of the Aircraft Loan as a line of credit on which to operate. (App. 47-48). Shortly after asserting these claims, plaintiffs sought leave to amend their complaint by interlineation to clarify that all plaintiffs, rather than just Dr. Stricker, were asserting claims against the individual directors, and that they were doing so in their capacity as creditors, not based on Dr. Stricker's capacity as a shareholder. (App. 53). The district court denied this request based on the fact that the amendment was being made by interlineation. (App. 58).

The individual defendants then filed motions to dismiss the claims against them, arguing they owed no duty to the plaintiffs. (App. 60, 77, 83, 90). The district court granted these motions and held that Dr. Stricker did not allege an injury that he suffered in his capacity as a shareholder, and therefore could not assert a claim against the board members for breach of fiduciary duty. (App. 97).

Plaintiffs then filed a motion for leave to amend their Complaint to make the changes set forth in their first motion to amend by interlineation and to drop certain defendants. (App. 106). Plaintiffs also filed a motion for reconsideration as a protective measure to the extent the district court might deem necessary to its review of Plaintiffs' motion to amend in light of the court's previous order dismissing those same defendants. (App. 141). This motion for leave to amend was filed after limited discovery had taken place, and before the deadline to file motions for leave to amend

set forth in the court's Scheduling Order. Plaintiffs attached a copy of their proposed Second Amended Complaint to the motion for leave to amend. (App. 112).

In their proposed Second Amended Complaint, plaintiffs alleged that due to Great Plains' insolvency or its being on the verge of insolvency, the Individual Defendants owed a fiduciary duty to preserve the company's assets for the benefit of creditors, including plaintiffs, and to pay its debts. Plaintiffs further alleged that the Individual Defendants breached their fiduciary duties to plaintiffs by failing to act in good faith and by making and/or failing to make decisions as Board members that would honor their obligations to plaintiffs as creditors and maximize the value of the assets of the company so that the debts could be paid. Plaintiffs alleged that the Individual Defendants acted in their own self-interest by seeking to preserve their positions and interests in Great Plains rather than maximize the value of the company's assets for creditors. Finally, plaintiffs alleged that as a direct and proximate result of the Individual Defendants' breaches of fiduciary duties, plaintiffs individually suffered damages. (App. 131-132).

Despite these allegations, the district court denied plaintiffs' motion to amend and their motion for reconsideration. The district court reaffirmed its dismissal order, holding that plaintiffs were required to file a derivative action on behalf of all creditors, similar to a shareholder derivative action, rather than suing directly on their own behalf. (App. 147).

SUMMARY OF THE ARGUMENT

At issue in this case are the rights and remedies available to creditors of an insolvent corporation against the corporation's board of directors. In this case, the defendant board members gambled away the company's last remaining dollars in an attempt to re-kindle the company's operations and restore value to the shareholders (themselves) even though those funds could have , and should have, been used to pay the company's past due obligations to the plaintiffs. Because the Board members' conduct directly related to the company's obligations to the plaintiffs, the plaintiffs had a right to proceed on their own behalf rather than derivatively on behalf of themselves and any other creditors who may have existed.

Plaintiffs filed this case as a direct action not to skirt the requirements of the derivative action statute but because there was no mechanism by which to assert their claims derivatively and because the claims they asserted sought relief for harm they suffered individually beyond the harm that was suffered by the corporation as a whole. These claims were adequately stated and should have been permitted to proceed.

ARGUMENT

I. The District Court Erred In Denying Plaintiffs' Motion For Leave To Amend The Complaint and In Dismissing Plaintiffs' Claims Against the Individual Defendants

A. Standard of Review

There are two issues in this appeal that have separate but related standards for review. The first issue is whether the Court properly denied plaintiffs' motion for leave to amend their Complaint. But, because the District Court refused plaintiffs' Second Amended Complaint on grounds of futility for failure to state a claim against the individual defendants, the standard governing motions to dismiss for failure to state a claim under Rule 12(b)(6) is ultimately the test to be applied by this Court.

Under Fed. R. Civ. P. 15(a), leave to amend a party's complaint "shall be freely given when justice so requires." In ruling on a motion for leave to amend, courts should consider: (1) whether the motion was filed in bad faith or with dilatory motive; (2) whether the motion was filed with undue delay; (3) whether leave to amend would be unduly prejudicial to the opposing parties; and (4) whether the proposed amendment would be futile. *Williams v. Little Rock Municipal Water Works*, 21 F.3d 218, 224 (8th Cir. 1994); *Mann v. Duke Mfg. Co.*, 166 F.R.D. 415, 416 (E.D. Mo. 1996); *see also Brown v. Wallace*, 957 F.2d 564, 566 (8th Cir. 1992)(unless there is a good reason for denial, "such as undue delay, bad faith or prejudice to the non-moving party, or futility of the amendment, leave to amend should be granted.").

In determining whether an amendment is futile, the plaintiffs' likelihood of success is not considered unless the claim is clearly frivolous. *Popp Telcom v. American Sharecom, Inc.*, 210 F.3d 928, 944 (8th Cir. 2000). Denying a motion for leave to amend is akin to dismissing the complaint for failure to state a claim. "[A] complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Fusco v. Xerox Corp.*, 676 F.2d 332, 334 (8th Cir. 1982) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Plaintiffs' allegations must be liberally construed in their favor. *Stifel, Nicolaus & Co. v. Dain, Kalman & Quail, Inc.*, 578 F.2d 1256, 1260 (8th Cir. 1978) ("the facts alleged by [plaintiff] must be taken as true, and [plaintiff] is entitled to the benefit of all reasonable inferences in his favor that may be drawn from the alleged facts"). "Thus, as a practical matter, a dismissal under Rule 12(b)(6) is likely to be granted only in the unusual case in which a plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief." *Fusco*, 676 F.2d at 334 (citation omitted).

B. Governing Law

The United States Supreme Court has held that the conflict of laws rules of the forum state, in this case Missouri, must be applied to determine which state's substantive laws apply. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941). This rule applies even when the district court exercises supplemental jurisdiction over state law claims. *See BancOklahoma Mortg. Corp. v. Capital Title*

Co., Inc., 194 F.3d 1089, 1103 (10th Cir. 1999); *Paracor Finance, Inc. v. General Elec. Capital Corp.*, 96 F.3d 1151, 1164 (9th Cir. 1996). "When determining choice-of-law issues in a tort action, Missouri courts apply the 'most significant relationship' test set out in § 145 of the Restatement, Second, of Conflict of Laws." *Goede v. Aerojet General Corp.*, 143 S.W.3d 14, 24 (Mo. App. 2004).

Plaintiffs do not believe that the choice of law issue is dispositive here. Nevertheless, the district court's application of Missouri law was erroneous. Missouri courts apply the law of the corporation's state of incorporation to breach of fiduciary duty claims against corporate officers and directors. *Ranch Hand Foods v. Polar Pak Foods, Inc.*, 690 S.W.2d 437, 444 (Mo. App. 1985); *see also St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 562 F.2d 1040, 1054 (8th Cir. 1977), *cert. denied*, 435 U.S. 925 (1978)(citing Restatement (Second) of Conflict Of Laws, § 309 (1971)) (law of state of incorporation applies absent some other state having more significant relationship). Because Great Plains is a Nevada corporation headquartered in Oklahoma, either Nevada or Oklahoma law governs plaintiff's breach of fiduciary duty claims in this case. Likewise, under Missouri choice of law principles, Nevada law governs the determination of whether plaintiffs' action is derivative or direct in nature. *See Burt v. Danforth*, 742 F. Supp. 1043, 1047 (E.D. Mo. 1990); *see also Kennedy v. Venrock Assocs.*, 348 F.3d 584, 589 (7th Cir. 2003) ("The question whether a suit is derivative by nature or may be brought by a shareholder in his own right is governed by the law of the state of incorporation.").

With respect to plaintiffs' claim for gross negligence, and absent discovery on the issue, the rule cited above would suggest Nevada law as well, though an evaluation of the Restatement factors, after discovery is conducted, may suggest either Oklahoma or Missouri law. Here, Great Plains' headquarters were in Oklahoma, the large majority of its officers and directors were located in Oklahoma, and all of its board meetings, including the decisions and conduct that caused the injury here, occurred in Oklahoma. On the other hand, plaintiffs all reside in Missouri and suffered harm in Missouri. Because discovery likely would have shed light on this issue, the district court should have considered Nevada, Oklahoma, and Missouri law.

Because the ultimate issue in this appeal is whether the individual defendants can, under any circumstances reasonably encompassed by the pleadings, owe a duty to all or any of the plaintiffs, the issue of "duty" must be analyzed under Nevada, Missouri and Oklahoma law.

C. Plaintiffs Stated A Valid Claim for Breach of Fiduciary Duty and Therefore the Amendment Was Not Futile

Plaintiffs' proposed Second Amended Complaint alleges that the individual defendants owed plaintiffs a duty as creditors of Great Plains. While the general rule is that corporate officers and directors only owe duties to the corporation and its shareholders, *see, e.g., Leavitt v. Leisure Sports Inc.*, 734 P.2d 1221, 1224 (Nev. 1987), when a corporation becomes insolvent, or is near insolvency, the company's officers and directors take on a fiduciary duty to the company's creditors.

"It is well established that when a corporation gets into the zone of insolvency, the fiduciary duties of its board expand from the corporation's stockholders to its creditors …." *In re Global Crossing Ltd.*, 295 B.R. 726, 745 (Bankr. S.D.N.Y. 2003). While the relationship between directors and creditors is typically contractual rather than fiduciary in nature, "[a]t the moment a corporation becomes insolvent, however, the insolvency triggers fiduciary duties for directors for the benefit of creditors." *In re Hechinger Inv. Co. of Delaware*, 274 B.R. 71, 89 (D. Del. 2002). "This is because when a corporation enters the zone of insolvency, the creditors—and not just the shareholders—are residual risk bearers whose recovery is dependent upon business decisions of the directors. In other words, in an insolvency situation, the directors can be said to be 'playing with the creditors money.'" *Id.*

Numerous courts have expressed and applied this duty. *See In re STN Enterprises*, 779 F.2d 901, 904 (2d Cir. 1985) ("although in most states directors of a *solvent* corporation do not owe a fiduciary duty to creditors, quite the reverse is true when the corporation becomes insolvent"); *Bank Leumi-Le Israel, B.M. v. Sunbelt Indus., Inc.*, 485 F. Supp. 556, 559 (S.D. Ga. 1980) ("In the case of an insolvent corporation, the directors and officers stand as trustees of corporate properties for the benefit of creditors first and stockholders second."); *In re Xonics, Inc.*, 99 B.R. 870, 872 (Bankr. N.D. Ill. 1989) ("When a corporation is insolvent its officers and directors stand in a position of trust not only to the corporation and its shareholders, but also to its creditors."); *In re Healthco Int'l, Inc.*, 208 B.R. 288, 300 (Bankr. D. Mass. 1997)

("When a transaction renders a corporation insolvent, or brings it to the brink of insolvency, the rights of creditors become paramount."); *New York Credit Men's Adjustment Bureau, Inc. v. Weiss*, 110 N.E.2d 397, 398 (N.Y. 1953) (when company is insolvent or rapidly approaching insolvency, the directors are "trustees of the property for the corporate creditor-beneficiaries"); *FDIC v. Sea Pines Co.*, 692 F.2d 973, 977 (4th Cir. 1982), *cert. denied*, 461 U.S. 928 (1983) ("when the corporation becomes insolvent, the fiduciary duty of the directors shifts from the stockholders to the creditors"); *Liability of Corporate Officers and Directors*, § 6.02 (7th ed.) (describing rationale behind fiduciary duty to creditors).

This duty is not dependent on the existence of bankruptcy proceedings because it is the fact of insolvency, not the filing for bankruptcy, that gives rise to the fiduciary duty to creditors. *Geyer v. Ingersoll Publications Co.*, 621 A.2d 785, 787-88, 790 (Del. Ch. 1992) ("the existence of the duties at the moment of insolvency rather than the institution of statutory proceedings prevents creditors from having to prophesy when directors are entering into transactions that would render the entity insolvent and improperly prejudice creditors' interests"); *Clarkson Co. Ltd. v. Shaheen*, 660 F.2d 506, 512 (2d Cir. 1981) (duty arises even when liquidation is not in sight). In fact, the proper exercise of the Board's duty to creditors may require it to sell the company or to dissolve it so that creditors can be paid. *See Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (discussing fiduciary duty to sell company at the highest price).

There are no published opinions applying the duty to creditors in either Nevada or Missouri, but the Supreme Court of Oklahoma has recognized that directors owe a duty to creditors when the company becomes insolvent. *Gentry v. Jeffrey*, 389 P.2d 519, 522 (Okla. 1964) (citing *Union Coal Co. v. Wooley*, 154 P. 62, Syl. ¶ 3 (Okla. 1915). Based on the overwhelming majority of courts that have recognized a corporate board's duty to creditors in such circumstances, there is no reason to believe that Nevada and Missouri courts would not follow this same approach.

Plaintiffs' proposed Second Amended Complaint alleges that Great Plains was at all relevant times insolvent or on the verge of insolvency. Based on the duty owed by these directors to the plaintiffs as creditors of a company within the zone of insolvency, plaintiffs stated a valid claim.

D. Plaintiffs Stated a Valid Claim for Gross Negligence and Therefore the Amendment Was Not Futile

Under Oklahoma law, "gross negligence" is defined as "the want of slight care and diligence." 25 Okl. Stat. Ann. § 6. It is characterized as reckless indifference to the consequences and falls short of an intentional wrong. *Myers v. Lashley*, 44 P.3d 553, 563 (Okla. 2002). As explained above, directors may owe a duty to creditors in addition to the shareholders when the company is insolvent. While no case law addresses this point, this common law duty, just like directors' duties to shareholders, can be based on negligence as well as fiduciary principles, and thus plaintiffs' claim for gross negligence should have been held to state a claim as well.

E. Plaintiffs Had Standing To Assert These Claims

In denying plaintiffs' motion for leave to amend, the district court held that even if the Great Plains' directors could be held to owe a fiduciary duty to creditors, plaintiffs lacked standing to bring this suit as a direct action rather than as a "creditor derivative action." This holding was wrong for two reasons: 1) Rule 23.1 does not permit creditors to file a derivative action, and 2) even if a "creditor derivative action" had been a viable alternative, it was not necessary due to the individual injury exception to Rule 23.1.

1. Rule 23.1 Does Not Permit Creditors to File a Derivative Action

Federal Rule of Civil Procedure 23.1 provides a mechanism for shareholders to sue derivatively on behalf of the corporation to enforce a right that rightfully belongs to the corporation. But that rule explicitly limits standing under that mechanism to "shareholders" of a corporation or "members" of an unincorporated association. *Darrow v. Southdown, Inc.*, 574 F.2d 1333, 1336-37 (5th Cir. 1978), *cert. denied*, 439 U.S. 984 (1978) ("[A] contract creditor of the corporation ... has no ownership interest and therefore no derivative standing [under Rule 23.1]"); *Dorfman v. Chemical Bank*, 56 F.R.D. 363, 364-65 (S.D.N.Y. 1972) (holding Rule 23.1 derivative standing not available to debenture holders as creditors, rather than shareholders, of the corporation and distinguishing cases conferring derivative standing on holders of debentures and warrants convertible into stock as equitable owners).

Every court that has addressed the issue of whether persons other than shareholders or members can assert a derivative claim under Rule 23.1 (or state law equivalents) has concluded that only shareholders and members, and not creditors, may use the derivative action mechanism. *See, e.g.*, *Darrow*, 574 F.2d at 1336-37; *Kusner v. First Pennsylvania Corp.*, 395 F. Supp. 276, 280-82 (E.D. Pa. 1975) (mere creditor could not bring a derivative action on behalf of the corporation), *rev'd in part on other grounds*, 531 F.2d 1234 (3d Cir 1976); *Dodge v. First Wisconsin Trust Co.*, 394 F. Supp. 1124, 1127 (E.D. Wis. 1975) (party that was at best a creditor of the corporation had no standing to bring a derivative action under Rule 23.1); *Brooks v. Weiser*, 57 F.R.D. 491, 494 (S.D.N.Y. 1972) (where the plaintiffs were clearly creditors, rather than shareholders, of the corporation they had no standing to sue derivatively); *Dorfman*, 56 F.R.D. at 364-65; *Harff v. Kerkorian*, 347 A.2d 133 (Del. Supr. 1975) (creditors of corporation had no derivative standing because only one who was a stockholder at the time of the transaction in question or whose shares devolved on him by operation of law could maintain a derivative action).

In its Order, the district court noted that all but one of the cases cited by plaintiffs arose in the context of a bankrupt corporation. Actually, *all* of the cases cited by plaintiffs to the trial court arose in the context of bankruptcy, though, as set forth above, there are cases that arise outside the context of bankruptcy. But by holding that plaintiffs lacked standing to file a direct action when the company had not yet filed bankruptcy, the court effectively precluded plaintiffs from seeking a remedy.

The district court did not specify in its order how plaintiffs could assert a derivative action on behalf of all creditors of Great Plains. In fact, there was no evidence, or even an allegation, that Great Plains had any creditors other than plaintiffs. The only theoretical remedy that plaintiffs may have had would have been to file a class action. But plaintiffs had no knowledge of any other creditors, much less a good faith belief that the creditors were so numerous as to make joinder impracticable sufficient to satisfy Rule 23(a).

Once the corporation files bankruptcy, some courts have recognized standing by the bankruptcy trustee to pursue claims on behalf of the unsecured creditors of the bankruptcy estate, thus in effect providing a "derivative" action on behalf of creditors. *See, e.g., In re Healthco Int'l*, 208 B.R. at 300. But because Great Plains was not in bankruptcy, plaintiffs had no method of filing a derivative action.

Since the filing of this appeal, Great Plains has filed for bankruptcy. To date, however, the trustee has not pursued derivative claims and, even if that occurs in the future, that does not resolve plaintiffs' individual injuries or in any other way impact the impropriety of the district court's ruling that plaintiffs failed to state a claim.

2. Even If There Were Some Mechanism for Asserting a Creditors Derivative Action, The Individual Injury Exception Permits a Direct Action

Nevertheless, if, by the analogy the court drew to shareholder derivative actions, plaintiffs could have filed a creditor derivative action, the same analogy supports the application of the "individual injury exception" applicable to shareholder

derivative actions. Under this exception, shareholders who suffer an individual injury separate from the injury to the corporation itself have standing to sue directly rather than derivatively.

Under Nevada law, an individual shareholder may pursue a direct breach of fiduciary duty claim against majority shareholders and directors when there is a direct injury to the plaintiff shareholder, independent of any injury suffered by the corporation. *Cohen v. Mirage Resorts, Inc.*, 62 P.3d 720, 732 (Nev. 2003).[1] Here, plaintiffs' proposed Second Amended Complaint alleged that they suffered harm directly as a result of the directors' decision not to remove plaintiffs from the Aircraft Loan, an injury that was not suffered by all creditors' generally. Great Plains was effectively operating on the credit of the plaintiffs because the airplanes it used in its operations were financed by plaintiffs. Great Plains assumed the Aircraft Loan and was contractually required to removed plaintiffs from responsibility for that note within one year of purchasing the company.

The cases do not discuss whether fiduciary duty claims by creditors outside the bankruptcy context should be brought directly or derivatively, but the cases that have

[1] Under Missouri choice of law rules, the law of Nevada, the state of incorporation of Great Plains, governs whether plaintiffs' action is derivative or direct. Whether Nevada, Oklahoma, or even Missouri law applies, however, is immaterial to the decision whether plaintiffs' may proceed in a direct action because Oklahoma and Missouri use the same basic approach to the determination of direct or derivative actions as Nevada. *See Johnson v. Render*, 270 P. 17, 19-20 (Okla. 1928) (holding that a direct cause of action by a shareholder is appropriate where the harm is suffered by the shareholder directly, rather than the stockholders collectively); *Centerre Bank of Kansas City, N.A. v. Angle*, 976 S.W.2d 608, (Mo. App. 1998) ("These cases illustrate that individual actions are permitted, and provide the logical remedy, if the injury is to the shareholders themselves directly ...."); *Dawson v. Dawson*, 645 S.W.2d 120, 125-26 (Mo. App. 1982) (a complaint alleging a direct injury to the plaintiff can support a direct action).

arisen outside the bankruptcy context have been direct actions. *Geyer v. Ingersoll Publications Co.*, 621 A.2d 784 (Del. Ch. 1992); *FDIC v. Sea Pines Company*, 692 F.2d 973 (4th Cir. 1982); *Rosebud Corp. v. Boggio*, 561 P.2d 367 (Colo. App. 1977); *see also Snyder Elec. Co. v. Fleming*, 305 N.W.2d 863, 871 n.3 (Minn. 1981) ("the district court can protect other creditors of the debtor by ruling they be joined as necessary parties or by appointing a receiver and ordering the debtor's assets sequestered, if and when, in its discretion, such measures are advisable").

In *In re Hechinger Investments*, the court found that the plaintiff creditors adequately stated a claim for breach of fiduciary duty against the directors for facilitating "the transfer of enormous value from the Debtors to themselves for no consideration and shift *all* of the risk of the Debtors' operations to their unsecured creditors." 274 B.R. at 74. Here, the Great Plains directors similarly shifted all the risk of Great Plains' operations to the plaintiffs by choosing to continue to spend the company's money rather than honor its obligation to remove plaintiffs from the Aircraft Loan and/or to shut the company down and use its remaining funds to pay off the Aircraft Loan. The board gambled the company's few remaining assets in an attempt to resurrect its operations, using what amounted to an unauthorized credit line from the plaintiffs. As a direct result of that decision, plaintiffs, and only plaintiffs, were forced to pay $6,555,508.46 to Union Planters to retire the Aircraft Loan. (App. 175). Because of this individual injury, plaintiffs should be entitled to pursue their claims directly rather than derivatively.

CONCLUSION

For the reasons set forth above, plaintiffs request this Court to reverse the Orders of the district court dismissing plaintiffs' claims against the Great Plains directors and denying their motion for leave to amend their complaint, and to remand this case with instructions that plaintiffs be permitted to pursue their claims as a direct action.

Respectfully submitted,

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/s/ Richard M. Paul III
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I hereby certify that on the 18th day of May, 2005, two (2) true and correct copies of the above and foregoing document was served via U.S. Mail, postage prepaid, addressed to:

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ADDENDUM

Order Granting Defendants' Motions to Dismiss 1

Order Denying Plaintiffs' Motion for Leave to File Their Second Amended Complaint; Denying Plaintiffs' Motion for Reconsideration of the Court's September 7, 2004 Order, and Dismissing all Claims Against Defendants Smith, Turnbo and Swartz 10